ARGENTINE-AMERICAN CHAMBER OF COMMERCE INC.

Newsletter

AACC

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AACC'S 2001 Annual Meeting

The Argentine-American Chamber of Commerce held its 2001 Annual Meeting at the University Club on April 26, 2001. The agenda presented by the AACC Chairman, Dr. Carlos Alfaro, included a discussion of the Chamber's activities during the past year, the appointment of Directors, a new Executive Director, as well as the 2001 Programs. On this occasion a panel discussion about the current economic situation in Argentina was included. Invited speakers were Mr. David Malpass, Bear, Stearns & Co., Mr. Alberto Ades, Goldman, Sachs & Co. and Mr. David Sekiguchi, Deutsche Bank Alex Brown. The presentations by the speakers were followed by a Q&A period in which members of the audience participated.

The new Board of Directors proposed and elected at the meeting is: Mr. Carlos E. Alfaro, Alfaro-Navarro, Ms. Agnes Junger, Agex.Com, Ms. Rita di Martino, AT&T, Hector Arzeno, Banco de Galicia y Buenos Aires, Mr. Ricardo Sturla, Banco de la Provincia de Buenos Aires, Mr. Gonzalo de las Heras, Banco Santander Central Hispano, Mr. George McReddie, Bear, Stearns & Co. Inc., Mr. Lawrence Cranch, Clifford, Chance Rogers & Wells LLP, Mr. Ezequiel Camerini, Fox, Horan & Camerini, Mr. Alberto Ades, Goldman, Sachs & Co., Mr. Andres Vacarezza, Goldman, Sachs & Co., Ms. Perla Kuhn, Hughes Hubbard & Reed LLP, Ms. Lois Jackson, IBM Latin America, Mr. Carlos Gottschalk, Johnson & Johnson, Mr. Brian O'Neill, JP Morgan Chase, Mr. Carlos Rohm, JP Morgan Partners, Mr. Jorge Lanus, Lanus Supply Co. Inc., Mr. Daniel Saffe, Mostar Maritime LLC, Mr. Angelo Francica, Standard Chartered, Mr. Manuel del Carril, Techint, Mr. Juan Navarro Castex, The Exxel Group, Mr. Jorge Carnicero, Trans-American Aeronautical and Mr. Alan Stoga, Zemi Communications.

The new Board appointed the following Officers:
Chairman: Mr. Carlos E. Alfaro, Alfaro-Navarro
President: Mr. Alan Stoga, Zemi Communications
Vice-Presidents: Mr. Hector Arzeno, Banco de Galicia y Bs. A.s.
Mr. Brian O'Neill, JP Morgan Chase
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Treasurer: Mr. Joseph Prikazky, Aventis Pharmaceuticals
Executive Director: Ms. Claudia Schaefer-Farré

Editor's Note

We are currently facing tough economic challenges arising from a perceived economic downturn in the U.S., that has implications for Latin America. Argentina has its own struggle to recoup the much needed economic growth and political stability.

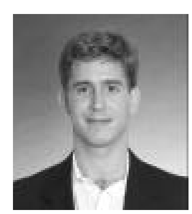
But it is now that we feel we have to re-double efforts, identify new ideas and continue the execution of meaningful projects. It is very motivating to find that needed level of energy and dedication at the Chamber.

In this issue we share with you our latest activities at the Chamber.

Our special contributors prepared thoughtful articles about Argentina's economic situation. Also, our PyMES Group reports some interesting initiatives in the PyMES sector. Finally, we included an article describing the legal issues surrounding an intellectual property case.

I would like to especially thank the efforts of our special contributors to our newsletter. We hope you will find this issue informational and helpful.

We are very enthusiastic about our projects at the Chamber and we look forward to sharing with you their progress and results. Thank you very much for your continued support.



Andrés is member of our PyMEs Committee and works at Goldman, Sachs & Co at its Investment Banking Department

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AACC's Finance Group holds meeting with Senator Salerno

By Victoria Anda

Several Members of the AACC's Finance Section, including Matias Cruces, Aleandra Scafati, Facundo Vazquez, Mercedes Franzini, Ariel Peculo, Victoria Anda, Constanza Ferro as well as the Chamber's Executive Director, Claudia Schaefer- Farré held a meeting with Senator Salerno on April 2, as she visited New York on official business. She was attending expositions both in the U.S and in Belgium to promote Mar del Plata's fishing industry.

Guillermo Guglielmotti, advisor to the Commission and Patricio Abate, member of an important fishing cooperative, accompanied Senator Salerno. They informed us about the difficulties the sector is going through in Argentina, their need to open up new markets, as well as the difficulties PyMEs generally face in Argentina.

The AACC introduced itself and its programs, and offered assessment in areas such as Business plan presentation, alternatives to obtaining financing, as well as information on US commercial and tax regulations that could be studied and potentially implemented in Argentina.

The AACC hopes to promote cooperation initiatives with the Commission, and with other organizations as well going forward.

Susana Salerno is currently President of the 'Small and Medium Size Business' Commission of the Legislature of the Province of Buenos Aires.

A Certified Public Accountant, Ms. Salerno has been Senator for the Province of Buenos Aires since 1993.

AACC's New Executive Director

Dear Members,

I joined two months ago the AACC as Executive Director. It is a great honor for me to undertake this role at the Chamber. Let me give you a little bit of my background. I am a Business Administration graduate from Universidad de Belgrano in Argentina and I recently completed a Certificate in Investment Banking at NYU.

I worked in credit and risk analysis at Deutsche Bank and Banco Santander Central Hispano, in Buenos Aires, and in Latin America equity research at UBS Warburg, in New York.

I am very pleased by the enthusiasm and energy I found at the Chamber and its different working Groups. I am very motivated by the number of projects in place and all the things we can do to further strengthen business relationships between U.S. and Argentina.

I look forward to closely working with you and achieving our mutual goals.

Best regards,

Claudia Schaefer-Farré

Claudia Schaefer-Farré is our new Executive Director at the AACC. She is actively promoting existing programs and activities and developing new events.

PONTIFICIA UNIVERSIDAD CATOLICA ARGENTINA

We are pleased to announce that we have signed another cooperation agreement with Universidad Católica Argentina ("UCA"), one of the top Universities in Argentina.

The agreement involves potential participations of our members in University conferences, workshops and events, internship programs, PYMEs matchmaking opportunities, and exchange of reports, field studies and economic information among other initiatives.

Founded on March 7, 1958 by the Argentine Episcope, UCA is one of the most prestigious Universities in Argentina, with several leading graduate programs Comprising Economics, Management, Law, Agriculture, Philosophy and Art among other degrees.

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Recent Developments in the Argentine PYMES sector

By Victoria Anda and Andrés Vacarezza

Argentine PYMEs (small and medium-sized businesses) are striving through several business and financial challenges magnified by a prolonged (and hopefully ending) economic recession that has hit the country in the past few years.

Perhaps it is in these times when opportunities can be identified, when business and financial professionals need to think and work harder to implement ideas and projects, despite an economic downturn. We believe, as well as other actors of the Argentine and global business and political community, in the long-term potential of Argentine PYMEs as a key sector to contribute to economic growth and employment.

It is our intention to present in this article some of the most recent developments in the PYMEs sector in Argentina, that show that the sector is far from being stagnant. In fact, new private PYMEs investment funds are being created, and the Argentine Government, through its Small and Medium Sized Secretary, plans to implement policies that will hopefully support Argentine PYMEs in the long term.

New Private Investment Funds targeting Argentine PYMEs

Some financial institutions have recently announced plans to create funds targeting Argentine PYMEs, such as the foreign-owned HSBC and the local Banco Credicoop.

HSBC announced in May of this year the creation of a $105 million fund to make equity investments in PYMEs of Argentina and Brazil. The investments could be in majority or minority stakes and would range between $5 and $25 million. The fund will increase its size to reach $300 million in year 2002 and will target a broad range of industry sectors such as telecommunications and media, food, services, automobiles and autopartists, wholesalers and retailers, chemicals and pharmaceuticals.

One could argue about the ability for any investment fund operating in Argentina or Latin America to "exit" its investments and achieve the return on investment required by its investors. According to HSBC announcement, their new PYME fund intends to invest in the next 5 years, and exit in the subsequent 5 years, signaling a long-term approach to the Region.

The Inter-American Development Bank (BID) signed and agreement with Banco Credicoop, the Argentine cooperative bank, to set up a $20 million investment fund focused in PYMEs by the end of year 2000 (*Buenos Aires Económico, 08/09/2000*). PYMEs would be able to request financing of up to $1.5 million, repayable over a maximum period of 10 years. The beneficiary would be able to buy back the share capital, put as a security. Companies with annual revenues of up to $1.5 million and less than 100 employees would be eligible. Banco Credicoop announced that the program would be launched at the beginning of year 2001 and expects 450 companies to take part in the program.

Promoting Competitiveness among Argentine PYMEs: The Government approach

We recently attended a conference (Buenos Aires, Argentina, on April 25 of this year) addressing the Argentine PYMEs competitiveness, held by Mr. Enrique Martinez, the Official in charge of the "Secretaria de la Pequeña y Mediana Empresa" ("Sepyme", the Secretary of Small and Mid Sized-Businesses), an organism equivalent to the Small Business Federal Administration (SBA) of the United States.

We wanted to share with you the perspective of a public official regarding small and mid-sized business challenges in Argentina, as well as his proposed solutions.

According to Mr. Martinez, there are three areas that need to be addressed to improve Argentina's competitiveness:

- The correction of *distortions originated in official regulations* (such as the "presumed income" tax for companies that do not even generate positive net income, or the tax to interest paid, originally intended to mitigate tax evasion arising from "self-loans") that raise production costs, as well as *distortions originated by the lack of appropriate regulations* in specific areas (such as an inadequate control of the Customs office or lack of controls to ensure that financial institutions lend to PYMEs in equitative equal terms).

- The correction of *distortions produced by macroeconomic policies or specific sectorial subsidies applied by other countries*, which inevitably affect the country's competitiveness.
- The correction of *structural weaknesses in the productive chain* of the Country

Mr. Martinez believes the Government should improve its efficiency and help to correct the above-mentioned distortions. He further explained the existing structural weaknesses and asymmetries in the Argentine economy. He supported his arguments with interesting statistics:

- *Exports have a lower average value per transaction than imports*. In 1998, the average value of argentine exports was of $298 per ton while imports where worth an average $1,290 per ton.
- *The exchange of capital goods is not balanced*. Capital goods exports represent only 7% of total exports, while imports represent approximately 55%. In nearly all developed countries (except New Zealand) the exchange of capital goods is more balanced, representing between 25% and 35% of purchases and sales.
- *Participation of multinationals in the production of goods is increasingly high*. This affects the degree of economic autonomy of a country. Currently, multinationals trading with its subsidiaries makes 30% of total Argentine imports. Considering the top 1,000 companies operating in Argentina, multinationals represented 34% of total sales in 1990 and 59% in 1998.
- *Argentina has considerable regional asymmetries*. The difference between the Gross Product of the Buenos Aires City and some of the interior provinces, such as Salta or Santiago del Estero is between 4 to 1 and 7 to 1. In the United Kingdom or Italia the biggest gap is 1.5 to 1.

Important messages arise from the presented statistics: Argentina seems to exchange "intelligence" for commodities; its productive structure involves a high presence of foreign corporations; there is a considerable disparity between the income of the City of Buenos Aires and the Interior of the Country.

In Mr. Martinez view, the potential solutions involve the design of instruments to strengthen the productive structure of the Country and the participation of all relevant actors in the economy: local subsidiaries of multinational corporations, large Argentine companies, PYMEs, locally elected politicians, and also the central government, responsible for promoting and tutoring the desired policy changes

Mr. Martinez presented a proposed strategy based in the following basic components:

- Link large national companies or subsidiaries of multinational companies with their PYMEs suppliers or clients, in nets that could constitute integrated productive systems with an active exporting approach
- Decentralize the responsibility of promoting, implementing, tutoring and supervising productive programs at the provincial and municipal levels
- Think of regional or sector production systems, instead of individual PYMEs as unit of analysis and subject of official support, aiming at instructing big corporations about the benefits of integrating/reinforcing small companies they interact with (and about the risks of not doing so)

Based on that strategic framework, the Sepyme intends to promote competitiveness among Argentine companies through the following initiatives:

- Creation of a new PYME guarantee vehicle called "Sociedades de Garantía Recíproca" ("SGR", Institutions of Reciprocical Guarantee").

  The aim of this vehicle, widely used in Spain and Italy, is essentially help PYMEs to obtain financing at a lower cost.

  There are currently over 30 SGR's being evaluated; the most relevant cases are the ones sponsored by the Mendoza Province with the Banco Regional de Cuyo, the Tucumán Stock Exchange, the Provinces of Jujuy, Rio Negro and Tierra del Fuego, Grupo Clarín, Grupo Perez Companc and others. The SGR "Garantizar", sponsored by the Banco Ciudad de Buenos Aires, has already been authorized by the Central Bank. The institutions sponsoring the SGR essentially act as guarantors ("protecting partners") in the SGR, therefore reducing the financing costs for the "participating partners", who are the heads of the PYMEs.

- Value Chain Programs ("Programas de Cadena de Valor")

  This program promotes agreements and strategic alliances between large companies and their PyME clients or suppliers. The Sepyme has already signed several agreements (in the corn producing sector, textile and construction) and plans to sign more agreements.

- PYME Export Program

  PYMEs with a regional or industrial-type affinity and exports strategies, are organized into groups. The services of a "commercial coordinator" are financed and the implementation of actions to improve the exports of goods is subsidized. There are currently around 20 groups comprising 150 companies of sectors as diverse as autoparts, furniture or frozen food.

- Large and Small Companies Exports

  The Largest argentine exporters are invited to share part or all of their international marketing infrastructures available with the PYMEs they interact with. Sepyme is currently working with firms such as Dupont, Arcor, Volkswagen, Peugeot and Siderar.

- Local Development

  The objective of the "Local Development" area at the Sepyme is to improve the possibilities of each province and municipality to better define their best productive profile and to implement it. Subprograms in this area include, among others, the formation of local teams and production development workshops and the creation of a "virtual net" of PYMEs in the Internet.

It is very encouraging for us to see that, in light of the important challenges for Argentine PYMEs, there are initiatives under development, tangible projects and people with energy working behind them in search of results to support PYMEs growth and improvement. We look forward to a multiplication of PYME-related initiatives in the near future, and, more importantly, to a meaningful project implementation. It is the goal of our PYMEs Group in the Chamber to be an active part in constructing a productive network to support PYMEs and matching Argentine companies with potential U.S. partners. We will keep you posted!

Don't Bet Against Argentina For Now - Argentina: The View From Strategy

By Thierry A. Wizman, Ph.D., Sage Hiley and Timothy Ramsey - Courtesy of Bear, Stearns & Co. Inc. - April 2, 2001

BEAR STEARNS

Summary

Our economists and we believe that the long-term solution to Argentina's current debt crisis is a resumption of economic growth. Policies that we believe would enable long-term growth include: 1) trade liberalization (including a reduction of it's high external tariff), which in turn would promote foreign direct investment and allow market-based prices; 2) tax reform, including a reduction in income taxes and VAT taxes, which would reduce tax evasion; 3) policies that promote labor market flexibility; 4) further de-regulation of industry aimed at reducing busines costs; and 5) de jure dollarization of the economy.

In the short term, however, we believe that avoiding default is crucial to the successful implementation of any economic plan. Honoring debts ensures a favorable capital market response to future policies, and generates good will among multi-lateral lending agencies that can assure the short-term solvency needed to eventually implement a long-term plan. Under the management of Economy Minister Domingo Cavallo, Argentina has resorted to aseries of measures in recent weeks that has enabled it to avoid default in the short term. In our view, *increasing political consensus* in Argentina has been an important factor enabling Mr. Cavallo to effect the measures necessary to avoid default in the short term. The series of events that helped avoid default culminated this week with a renewed comitment by the International Monetary Fund to maintain a $14 million loan program.

A continuation of the more favorable political environment and political consensus, in the context of the breathing room produced by the IMF's support, will be an important determinant of whether the long-term measures needed to resume growth are politically palatable and successfully implemented. With Mr. Cavallo's immediate goal assured, enough domestic political capital and market patience *may* have been bought to now introduce the needed growth-oriented reforms. These are positive developments that warrant our "neutral" — rather than "underweight" recommendation in Argentine equities, especially in light of their low valuation using the historical standard. Although the risk of long-term default demands caution, and a re-exmination if growth does not resume, Mr. Cavallo's success domestically and with the IMF to date, and the prospect that structural reforms may be part of a long term economic plan to be released in coming weeks suggest that investors who are underweight Argentina should move to neutral and that short positions be unwound, pending further developments over a three-month horizon.

Building Political Support

Since his appointment as Economy Minister, Domingo Cavallo has employed three successful political tactics: *gradualism, discretion, and rhetoric*. Specifically, he has released his program in stages; he has given little detail on the structural reforms he would implement if the economy starts growing; and he has used the rhetoric of economic "activation" rather than the less politically palatable "economic adjustment" to shelter his cause. His political strategy has allowed political cohesion and political consolidation to build, as formerly opposing factions have been largely co-opted or muted. While Argentina was characterized by an inordinate amount of poliical in-fighting as recently as November, Cavallo appears to have gained favor with political factions that had previously acted in a highly obstructionist manner toward the government: Radical Party traditionalists, Peronist leaders, and members of the governmnet's junior party, the Frepaso. Consolidation of political power was evidenced when the Argentine Congress granted the government special legislative powers under Article 76 of the Constitution in April. The measure, which empowered Mr. Cavallo to implement economic decrees within a broad mandate unencumbered by the Congressional approval process, was passed with large Peronist backing. That it was also supported by important Peronist governors such as Carlos Ruckauf (Buenos Aires Province) and Jose Manuel de la Sota (Cordoba), who are believed to be seeking the nomination of their party in the 2003 race for President, suggests a significant de-politicization of the opposition party in regard to economic policymaking. In a similar vein, ostensible allies of the government, such as Radical Party traditionalists and members of the governing coalition's junior party, the Frepaso, have noted Mr. Cavallo's role in closing the ideological gap and reducing political divisiveness. This is especially important in light of the strident opposition received by Mr. Cavallo's predecessor, Ricardo Lopez Murphy. Argentina's typically combative labor unions have so far failed to challenge Mr. Cavallo publicly.

In effect, the economy minister's use of gradualism, discretion, and rhetoric have allowed him to fulfill an important preliminary goal: building support from many quarters for what was previously a weak government.

Avoiding Default

Mr. Cavallo's political strategy has at times perturbed the markets. Pessimists point to: 1) too much gradualism; 2) a lack of important long-term structural measures and overemphasis on Convertibility reform; 3) "overbearing" public rhetoric; and 4) the use of important time to fight marginal political battles.

But the economy minister used the political support garnered by his political strategy to wage and win a political battle that has allowed him to force enough flexibility on the financial system to achieve his *immediate* short-term goal — avoiding default and devaluation. Avoiding default was the result of important measures effected not without a political battle that Mr. Cavallo would have been ill-suited to fight without the political support he gained through his strategy of gradualism, discretion, and rhetoric.

In this regard, it is imporant to note that the IMF's package of last year did not preclude short-term default by Argentina in the second quarter of 2001. With a large total amortization in March ($2.4 billion), no further IMF disbursements until June (the first and only to date was in January), and a first-quarter deficit well above the IMF target ($3.1 billion versus $2.1 billion), Argentina was left with little if any financial cushion by end-March. Without corrective measures, default might have happened in April.

But April's gap was largely financed by amending the Central Bank Charter to allow the central bank to finance the Treasury by buying public bonds ($500 billion) and lowering reserve requirements to allow banks to buy $2.0 billion in a new bond issue. Using bonds to comply with reserve requirements represents a possible (extra) $3.0 billion in bank liquidity. Possible further measures, like the ability of banks to convert offshore reserves to public bonds, may release an additional $5.5 billion under the most liberal minimum solvency requirements being discussed for new reserve requirements. Mr. Cavallo's measures reduced bank solvency and eroded the supervisory power of the central bank, but addressed the short-term fiscal imperative at hand. The measures imposing new central bank rules brought strong resistance from the monetary authorities and the head of the Central Bank, Pedro Pou, who viewed the new rules as compromising the spirit of the Convertibility Law. But the economy minister was abetted by the support of the government and the public, as well as key Peronists on the Congressional Commission of Inquiry that recommended that Mr. Pou be removed from the central bank and replaced with a Cavallo ally. In effect, Mr. Cavallo used his political support to wage and win a political battle that allowed him to force enough flexibility on the financial system to stave off a near-term default.

Bringing Multilateral Support

Until last weekend, the public sector was still far from having secured financing for the whole of 2001. Indeed, the month of May has large amortizations ($2.9 billion) and is likely to have a large deficit. Giving effect to pending Letes amortizations, existing rollover commitments by banks, new funding by pension funds, and multilateral and bilateral aid, Argentina would still have had a short-term (2001) financing gap of roughly $4.0 billion, considering neither last Friday's new tax and spending announcements, nor the prospective effects of a debt swap or a further.loosening of the bank's reserve requirements.
However, having earned some trust in April by declaring that Argentina would not default and then finding political support to ensure that outcome, Mr. Cavallo may have earned the goodwill to secure the recent IMF support. This was needed because barring renewed access to financial markets (or further erosion of the banking system's Convertibility cushion), the 2001 financing gap could conceivably be made up by the combination of the announced swap of Letes or Bontes, further tax and spending measures, and renewed IMF terms that ensure that the disbursement schedule for $3.8 billion remaining in 2001 is honored and/or rephased.

Following Mr. Cavallo's meetings with IMF chief Horst Koehler and the U.S. Treasury Secretary this past weekend, IMF negotiators and Argentina agreed on a new set of policies (subject to IMF board approval) that would accelerate the disbursement of the IMF's commitment to Argentina under the agreement of last year. Presumably in return for rephasing disbursements and waiving Q1's fiscal lippage, Mr. Cavallo proposed a further raising of the financial transaction tax to 0.4% (from 0.25%), the elimination of VAT exemptions on consumable items, a 15% capital gains tax on unlisted equity shares, and spending cuts of $900 million.[1] All told, the measures are expected to close 2001's anticipated fiscal gap. Although the governmnet is unlikely to receive additional multilateral or bilateral help, the IMF did indicate that $9 billion of IMF funds is pending disbursement through the end of 2003, so there is further scope for front-loading payments. Echoing our thoughts here, the IMF acknowledged that Mr. Cavallo's consolidation of political support helped ensure his ability to close the fiscal gap.
Also included in the series of announcement was a proposal for a *voluntary* swap of long-term debt for short-term debt. As Argentina has some $70 billion in debt coming due during the period 2001-2005 (of total debt of

$130 billion), a swap for any amount larger than $20 billion, as rumored, would greatly improve its amortization profile. Like the new IMF agreement, talk of a swap, which may include both local and external debt (and does not require IMF approval), would have been hardly feasible had Argentina defaulted in April or failed to secure the IMF's support. Moreover, as much of the debt prospectively involved in the swap in local debt held by a handful of banks, Mr. Cavallo's ability to convince the banks to accept the swap at favorable terms should be viewed as an indication of his political vigor.

Next Steps

With enough domestic political capital built to effect short-term unpopular measures and with sufficient IMF support to continue to assure no near-term default, the stage <u>may</u> be set for Mr. Cavallo to *now* begin to introduce the necessary structural reforms that may allow the economy to grow. Among the structural measures that are already announced or are to be possibly announced in coming weeks are:

1. Reducing the VAT on capital goods to 10.5%, as well as the removal of import duties on capital goods already announced to help businesses finance plant and equipment expenditures.
2. Further consolidation of the tax system and enforcement of tax collection via methods like the financial transaction tax, which effectively prepays the VAT and income tax, and may allow an overall *reduction* in tax rates.
3. Tax-based industrial policy aimed at reducing taxes for local industry, if complementary measures are obtained from local governments and concessions obtained from labor unions to make the labor market more flexible.
4. Further changes in the central bank's charter, seeking to make banks more amenable to commercial lending.
5. Deeper state reforms, possibly targeting the social security administration (Anses) and the system of retiree health benefits (Pami).
6. Broad industrial deregulation aimed at reducing the Argentine cost and attracting new <u>foreign</u> investments.
7. Further negotiations with Brazil on reducing Mercosur's common external tariff and liberalizing the trade regime.
8. **Ultimately, de jure dollarization of the economy may be implemented as a means of lowering currency risk and reducing interest rates, if all else fails.**

Ultimately, of course, Mr. Cavallo's ability to do all this will depend on his ability to sustain his political standing. While we view a political "fall from grace" as a principal risk facing him, his evident success so far leads us to recommend not assuming a short position against Argentina now. **Rather, the "neutral" recommendation we have advocated since early November 2000 is warranted, pending further developments over a three-month horizon, especially in light of the relative cheapness of the benchmark Argentine equities.** If a resumption of growth is not evidient, or if the long-term growth-oriented our economists hope to see are not implemented, we would review this recommendation.

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Argentina and the Markets

By Matias Silvani - May 9, 2001

Matias is a member of our Economic Analysis Committee and works at UBS Warburg as Latin America Economist

Domingo Cavallo came back as Minister of Economy and, for better or worse, lost no time putting his imprint on the country's policy framework. After almost two months upon his arrival, however, many doubts persist about his agenda, and financial markets reflect this, with spread levels still considerably higher than when he took control over the Ministry. While to some extent this can be explained by miscommunication and poor timing of some of the initiatives, there is still genuine concern out there about the country's short term, let alone long term prospects. What is going on? Is the market correctly assessing risk or are they missing the point?

Let's review the strategy set in place. At the time of his arrival, the country faced, at minimum, a number of problems: a fiscal cash flow problem on top of unresolved structural issues, a competitiveness problem inhibiting investment, a deep social problem brought about by two plus years of recession, and last but not least an unresolved political crisis undermining local confidence. Cavallo's strategy is to a large extent designed to address these issues and restrictions. His first and essential contribution was on the political front, easing political tensions in the country and bringing back a sense of stronger leadership**. This is hugely important**, because in the minds of many Argentines, the past 15 months of political and policy drift under weak leadership were as much a problem as concerns about the direction of the policy.

On the economic front, measures (still a work in progress) target fiscal concerns and overall growth. Major initiatives include the imposition of a 0.4% tax on financial transactions, elimination of VAT exemptions and distortive taxes, expenditure cuts to offset 1Q lax spending, active policy to specific sectors most battered to recover competitiveness, liberation of the financial system's reserves to help finance the public sector, a revision of the country's tariff policies to facilitate a recovery of investment and promote--albeit temporary--import-substitution of consumer growth, and lastly a major revision of the convertibility regime, proposing to peg the peso to an equally weighted basket of dollar and euros, once the euro attains parity to the dollar. Some of these **initiatives created anxiety and confusion among locals and foreigners alike, as it moved the policy mix preference into the "discretionary" territory as opposed to the "rules" policy approach** carried out in the country in recent memory.

In the end, however, the core (and aim) of the program is to construct a more business--and investment--friendly Argentina by tearing down barriers to competition and productivity, putting together a "competitiveness shock" large enough to generate a macroeconomically significant investment response. **This is also positive--there is no imaginable positive fiscal story without addressing growth**, but there will be no chance to implement this medium term goal without also addressing short-term concerns.

And this is where the market reaction comes into place. The country still faces a severe short-term concern: a fiscal cash flow situation, not quite solved. **To put it simply, the fiscal deficit and capital market constraints put pressure on the country's financing, questioning its ability to pay back debt obligations in the short term**. Moreover, the burden of an even heavier debt amortization schedule in the coming year adds doubts about the viability of the model. **In other words, for the market, the problem is the country's deficit and its filthy debt**. To that end, Cavallo and the government are working on these issues as we write, and there is room for optimism ahead. First, a revised IMF agreement will be signed soon, disbursing much needed multilateral funds in the coming weeks and hence easing immediate cash flow concerns. And second, a debt exchange is on its works to ease future amortization needs, an important element to surpass the current "emergency mode". **A successful exchange, determined by the size and interest rate, would substantially alleviate financing needs for the next years. This is again positive, and the fact that many Argentines hold debt gives hope for a successful result**. Note, however, that poor market sentiment and deteriorating fundamentals mean a successful debt exchange now appears a necessary but perhaps not sufficient condition to clear the country's financing horizon.

These short term but distressing issues are in the works, and returning to Cavallo's medium term agenda will crucially depend on their success. This is important; after all, focus on fiscal, competitiveness and structural issues solves the growth problem and consequently "the" debt problem. And without a resolution on these issues markets are likely to continue impasse. So, are markets assessing risk correctly? Come to your own conclusion…
Matias Silvani - Economist, Latin America Economic and Strategy Research -UBS Warburg
(by the way, these are my comments and not necessarily the bank's view!)

Supreme Court Expresses Caution but Does Not Negate Trade Dress Protection for Features Disclosed by an Expired Patent

Courtesy Hughes Hubbard & Reed LLP- By Perla Kuhn- Intelectual Property Advisory - *May 2001*

On March 20, the U.S. Supreme Court in TrafFix Devices, Inc. v. Marketing Displays, Inc., 2001 U.S. Lexis 2457 (March 20, 2001), decided the question of whether an expired utility patent precluded eligibility for trade dress protection (i.e., protection for the overall appearance of goods and services) under the Lanham Act. While leaving open the theoretical possibility that a holder of an expired utility patent may claim trade dress protection in its product's design, the Court held that an expired utility patent is "strong evidence" that the features claimed in that patent are functional and therefore not subject to protection.

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The dispute arose after TrafFix Devices, Inc. ("TrafFix") reverse-engineered a dual-spring mechanism designed to allow road signs to withstand heavy winds and incorporated the mechanism into its own signs. The design of the spring mechanism was the subject of an expired utility patent held by Marketing Displays, Inc. ("MDI"), which brought suit for trade dress infringement. TrafFix conceded that it had copied MDI's spring mechanism design, but asserted that, because that design was the subject of an expired utility patent and was functional, it was not protected under trademark law. Resolving a conflict among other several circuits, the Supreme Court held that the existence of a utility patent does not necessarily foreclose trade dress protection. However, because functionality of MDI's design was established, the Court held for TrafFix and determined that whether that design had acquired secondary meaning need not be considered.

Recognizing that trade dress can be protected under federal law if it serves the purpose of source identification, the Court signaled the limited availability of trade dress protection for unregistered product features by emphasizing the statutory presumption that such features are functional and holding that, where these features are the subject of an expired utility patent, a party seeking trade dress protection bears a "heavy burden" in overcoming that presumption.

In reaching its decision, the Court also provided additional guidance on the appropriate test for analyzing the functionality of product features. The Court rejected the Sixth Circuit's "competitive necessity" test as an incomplete formulation of the functionality inquiry, distinguishing the facts in TrafFix from cases where the central question is aesthetic functionality. If the issue is aesthetic functionality (i.e., when the product is purchased, at least in part, for aesthetic reasons such as in the case of a heart-shaped candy box or when color is a feature of the article), the first inquiry is whether the product feature is a competitive necessity. In cases not involving aesthetic functionality, the question of competitive necessity need not be reached where the product feature is essential to the use or purpose of the article of affects the cost or quality of the article. Applying this test here, the dual-spring design was not an arbitrary or incidental flourish in the configuration of MDI's product; it was the reason the device worked. Further, the file of the expired patent established that the dual-spring design affected the cost of the article; while the device could use three springs, that would unnecessarily increase the cost.

Viewed in the context of its decision last year in Wal-Mart Stores, Inc. v.Samara Brothers, Inc., 529 U.S. 205 (2000), the Court's opinion in TrafFix continues its message of restraint in the area of trade dress protection for product features. While the possibility of trade dress protection still exists for arbitrary, incidental or ornamental aspects of product features that may be incorporated within patent utility claims, a holder of an expired utility patent in that product is unlikely to ever succeed in a claim of trade cress protection for product features covered by that patent.